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Address of the late Chief Justice Vinson to American Bar Association, St. Louis Daily Record, Sept. 8, 1949, col. 7 10

IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

No. 516

CHEMICAL BANK & TRUST COMPANY,

Petitioner,

v.

PRUDENCE-BONDS CORPORATION (NEW CORPORATION), ET AL.,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION

Opinions Below

The opinion of the Court of Appeals for the Second Circuit (RB. 142-164)[1] is reported at 207 F. 2d 67.

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[1] The letter "R" refers to pages of the Appendix to the Brief below of Objectors-Appellants Prudence-Bonds Corporation (New Corporation), et al. (gray cover).

The letters "RW" refer to pages of the Appendix to the Brief below of petitioner appellant-appellee Chemical Bank & Trust Company, as Trustee (white cover).

The letters "RB" refer to pages of the Appendix to the Brief below of Objectors-Appellees Prudence-Bonds Corporation (New Corporation), et al. (blue cover), in which the proceedings in the Court of Appeals are bound.

The letter "F" refers to the Special Master's numbered findings of fact contained in his Report printed at R. 74-240.

The opinion of the District Court is not reported but is printed in the record (R. 250-267).

The opinion of the Special Master is not reported but is printed in the record (R. 74-240).

Jurisdiction

The judgment of the Court of Appeals was entered on August 20, 1953 (RB. 165). Petitioner's petition for rehearing (RB. 166-173) was denied on October 5, 1953 (RB. 198).

The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

Question Presented by Petitioner

The question petitioner seeks to present is whether the Court of Appeals may "disregard" the provisions of a trust agreement "and the applicable law of the State of New York and surcharge the trustee on the basis of the court's own views of socially desirable standards, developed long after the fact" (Pet., pp. 3-4).

This is not a proper question, but rather an unwarranted charge against the Court of Appeals framed in disregard of its decision. Petitioner's question assumes that this Court: (a) would consider and answer in the negative the question whether the acts for which petitioner has been surcharged were, as the Court of Appeals held, negligent and unauthorized; (b) would consider and answer in the affirmative the question whether the Court of Appeals disregarded the Trust Agreement; and (c) would consider and answer in the affirmative the question whether the Court of Appeals disregarded applicable State law.

These several further questions, which would have to be determined before reaching the question petitioner seeks

to present, should not be considered. They have not been presented by petitioner, and, necessarily, would involve review of issues of fact disputed by and found against petitioner below.

Petitioner states, "the petition does not seek review by this Court of the facts below" (Pet., p. 13). The facts below include findings of fact made by the Special Master after a protracted trial (RB. 143), and accepted by the Court of Appeals on cross-appeals, that petitioner, in committing the acts for which it has been surcharged in an amount found to be the loss to the Trust Fund, was negligent and violated express provisions of the Trust Agreement (F. 121, 212, 219-221, 232, 242; R. 163, 184, 186, 188, 190, 264-266); provisions which the Court of Appeals characterized as "explicit * * * beyond dispute" (RB. 155; 207 F. 2d 76). These findings of fact, which petitioner here accepts, conclusively negate the assumptions petitioner makes in the question it seeks to present.

Statement

The case involves the reorganization of Prudence-Bonds Corporation, Debtor, under the Bankruptcy Act, and, more particularly, a proceeding had in the reorganization court, Eastern District of New York, for the judicial settlement of the account of petitioner, Chemical Bank & Trust Company, Trustee under a Trust Agreement with the Debtor securing a Series of Prudence-Bonds known as "Fifteenth Series" (R. 24-54).

When the Debtor went into reorganization it had outstanding eighteen Series of bonds, each of which was secured by a trust fund, consisting of mortgages, cash and other securities, held by a Bank as trustee under a trust agreement with the Debtor (F. 3, 4, 20, 23; R. 124-125, 129-131). Eleven Banks were trustees of the eighteen Series

(R. 55-56). The bonds of all Series were guaranteed by The Prudence Company, Inc., an affiliate of the Debtor, which also went into bankruptcy reorganization, and, like the Debtor, was also found to be insolvent (F. 5, 8, 17, 18; R. 125-127, 129).

A Plan of Reorganization of the Debtor was confirmed which provided, in part, for a new corporation (also named Prudence-Bonds Corporation) to be owned by the bondholders, an extension of the maturity of the bonds and changes in interest provisions (F. 29, 31-35; R. 131-132). Under the Plan, one of the eleven Bank trustees became successor trustee of all eighteen Series under a Supplemental Trust Agreement with the new Prudence-Bonds Corporation (F. 37; R. 133).

Upon confirmation, jurisdiction was retained to carry out the Plan (F. 30; R. 132). To that end, the reorganization court, among other things, approved the appointment of the successor indenture trustee, approved the Supplemental Trust Agreement, and directed the original indenture trustees to transfer the trust funds to the successor trustee and to account in the reorganization court for their acts as trustees (F. 37, 41, 43; R. 133, 136).

Each of the indenture trustees submitted to the jurisdiction of the reorganization court, filed its account and petitioned for the judicial settlement thereof and a discharge from all liability as trustee (F. 45; R. 137). The jurisdiction of the reorganization court over the accountings was upheld in *Central Hanover B. & T. Co.* v. *President & Directors of the Manhattan Co.* (C. A. 2), 105 F. 2d 130. On the mandate of the Court of Appeals in that case, the reorganization court decreed that it had and thereby exercised "full, complete and exclusive jurisdiction" to settle the accounts and to hear and determine all objections thereto (R. 55-56).

Objections to the accounts were timely filed and there then ensued much further litigation in the proceedings

which resulted in four other decisions of the Court of Appeals, each of which this Court declined to review.[2]

The instant case, involving petitioner, Chemical Bank & Trust Company, Trustee of Prudence-Bonds, Fifteenth Series, is the last of these eighteen accountings (RB. 142).

The Trust Agreement securing the Fifteenth Series was made in New York in December, 1928, between the Debtor and United States Mortgage and Trust Company, as Trustee (R. 273, 317). In June, 1929, prior to the date of any transaction herein involved, petitioner succeeded United States Mortgage and Trust Company by merger (R. 373).

A summary of various provisions of the Trust Agreement is contained in the Master's Report (R. 79-84) and in the opinion of the Court of Appeals (RB. 144-147; 207 F. 2d 70-72). We shall later refer to certain of these provisions, including Article I, Section 6, which governed releases and substitutions of Trust Fund securities (R. 283-284). Suffice it to state here that there is no basis for petitioner's statement that the "fundamental plan of the trust agreement" was that the Trust Fund was to be "a revolving fund to pay off the bonds as they matured serially" (Pet., p. 6). The Trust Agreement created an express trust (*Manufacturers Trust Co.* v. *Kelby*, *supra*), and established a Trust Fund, consisting of bonds and mortgages, cash and other securities, "to secure the payment of" the Fifteenth Series bonds, "the performance and observance of all the covenants and conditions" of the Agreement, "for the equal and pro rata benefit and security of" the bondholders, and "for all the other uses and purposes and upon the terms" therein "declared and expressed" (R. 274-275, 286).

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[2] *Manufacturers Trust Co.* v. *Kelby* (C. A. 2), 125 F. 2d 650, cert. denied, 316 U. S. 697; *Brooklyn Trust Co.* v. *Kelby* (C. A. 2), 134 F. 2d 105, cert. denied, 319 U. S. 767; *President and Directors of Manhattan Co.* v. *Kelby* (C. A. 2), 147 F. 2d 465, cert. denied, 324 U. S. 866; *Prudence-Bonds Corp.* v. *State Street Trust Company* (C. A. 2), 202 F. 2d 555, cert. denied, ... U. S. ....., 74 S. Ct. 47.

Petitioner, like the other indenture trustees, duly filed its account, covering its acts and transactions and those of its predecessor from the inception of the Trust, and petitioned the reorganization court for the judicial settlement thereof and a discharge from all liability as Trustee (R. 34, 38). The account set forth in debit and credit form the mortgages, cash and other securities received in trust, released and disbursed, changes in securities, collections on securities, bonds authenticated, bonds cancelled and other transactions (R. 41-54).

Objections to petitioner's account were timely filed by a bondholder and by the new Prudence-Bonds Corporation and the Reorganization Trustee of the Debtor and were joined in by other bondholders (R. 59, 71; F. 55-56; R. 139-140).

The account and objections were referred to a Master to take testimony and to hear and report on the facts and the law (R. 74).

There were three objections to petitioner's account, numbered "First", "Second" and "Third" (R. 59-65), two of which, the "Second" and "Third", were ultimately sustained by the Court of Appeals which surcharged petitioner thereunder in the total sum of $1,061,966.66, plus interest at 3% (RB. 142-164; 207 F. 2d 67).

The issues raised by the objections were, in large part, issues of fact, particularly the issues, disputed by petitioner at all stages of the case below, whether Trust Fund mortgages were in default on the dates of the various transactions objected to and the length of time the mortgages remained in default. At the protracted trial before the Master, fourteen witnesses testified and approximately 190 exhibits were introduced in evidence (RB. 143). The Master's Report, which the Court of Appeals described as "thorough and comprehensive", contains 468 separately numbered findings of fact (RB. 143; 207 F. 2d 70).

FIRST OBJECTION. This objection need not be discussed since it was dismissed below (R. 84-87, 252; RB. 147-148; 207 F. 2d 72-73).

SECOND OBJECTION. This objection involved petitioner's acts on twelve dates between October 31, 1930 and August 17, 1931, in releasing to the Debtor a total of $1,045,250 of Trust Fund cash in violation of the Trust Agreement, with particular reference to the release clause, Article I, Section 6 (R. 61-62). This section authorized petitioner to release Trust Fund cash and securities in three different ways: (1) upon substitution of an equal amount of other eligible securities; (2) against delivery of an equal amount of Fifteenth Series bonds for cancellation; (3) as "excess" when the Trust Fund, properly computed, exceeded the bonds outstanding (R. 283-285). Petitioner's authority to release cash or other securities was, however, subject to three express provisos of Article I, Section 6. The first proviso prohibited all releases if the Debtor became in default in the payment of principal or interest on any of the Fifteenth Series bonds (R. 283). The second proviso required that after any release the Trust Fund contain cash, or securities not in default in the payment of principal or interest, in amount or value not less than the principal amount of bonds outstanding (R. 119, 284; RB. 149-154; 207 F. 2d 73-77). The third proviso, which the Court of Appeals found to be "explicit * * * beyond dispute" (RB. 154-155; 207 F. 2d 76), prohibited all releases of cash and non-defaulted securities if "any" mortgage collateral in the Trust Fund was "in default in the payment of principal for more than 60 days" (R. 284; RB. 154-155; 207 F. 2d 76).

The release clause, Article I, Section 6, further provided for what petitioner calls "Certificates of Non-Default" (Pet., p. 8). The provision was that petitioner "may accept as conclusive the written statement of any officer of the (Debtor) Corporation as to whether or not any securities deposited in the Trust Fund are in default in the payment of principal or interest" (R. 284).

The Master found as a fact that petitioner "did not receive, in connection with any of the releases of cash enumerated in the Second objection herein, any written statement of an officer of the Debtor as to whether or not any securities deposited in the Trust Fund were in default in the payment of principal or interest" (F. 207; R. 183). The Master further found as facts that each sum of cash covered by the Second objection was released by petitioner from the Trust Fund as "excess" without receiving anything in substitution; that on the date of each release mortgage collateral in the Trust Fund was, "to the knowledge of" petitioner, in default in the payment of principal for more than 60 days; that on the dates of certain of the releases mortgage collateral was, to the knowledge of petitioner, in default in the payment of interest; that after each release the total amount of cash and non-defaulted securities remaining in the Trust Fund was less than the principal amount of Fifteenth Series bonds then outstanding; that each of the releases of cash was unauthorized and violated both the second and third provisos of the release clause; and that petitioner, in permitting the releases, was "grossly negligent" and caused a loss to the Trust Fund of the sum of $1,045,250 (F. 145-148, 203-204, 205, 206, 211, 212, 216; R. 119, 170-171, 181-182, 184, 185).

Upon these findings of fact, the Master concluded that the Second objection should be fully sustained and surcharged petitioner thereunder in the sum of $1,045,250 (R. 237).

The District Court Judge, upon review of the Master's Report, accepted almost all of the Master's findings of fact,[3] but reduced the Master's surcharge under the Second

[3] The District Court Judge, without comment or stated reason, struck out the word "grossly" from the Master's findings that petitioner was "grossly negligent" (R. 264). It was, however, not necessary to establish gross negligence to sustain the objections; the Trust Agreement here does not contain the frequently condemned exculpatory clause relieving a trustee of liability save for gross negligence and bad faith (R. 273). The finding of gross negligence was perti-

(Footnote continued on following page.)

objection to $142,500, relying upon the decision of the Court of Appeals in *President and Directors of Manhattan Co.* v. *Kelby* (C. A. 2), *supra,* involving the accounting by the Bank Trustee of the Debtor's Fifth and Ninth Series bonds (R. 252-262).

On cross appeals, the Court of Appeals held that the District Court Judge had misinterpreted its decision in *President and Directors of Manhattan Co.* v. *Kelby, supra,* and, applying the "ruling and rationale" of that decision to similar facts of the instant case, reinstated the Master's surcharge under the Second objection (RB. 149-155; 207 F. 2d 67-77).

THIRD OBJECTION. This objection involved six transactions of petitioner in accepting and cancelling Fifteenth Series bonds in lieu of cash collected by the Debtor on account of principal of mortgages in the Trust Fund (R. 63). Petitioner, under Article III, Section 1(h), of the Trust Agreement, had the right to accept for cancellation paid bonds of certain maturities in lieu of principal collections on Trust Fund mortgages (R. 299-300). These six trans-

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nent only to the questions whether the surcharges should bear interest at the full legal rate and whether petitioner should pay the expenses of the proceedings necessary to uncover its wrongs. Petitioner was charged with interest only at 3% and was not charged with the expenses (RB. 155-157). The Court of Appeals said: "The Trustee does appear to us negligent, whether we apply further descriptive adjectives or no" (RB. 156; 207 F. 2d 77). The degree of petitioner's negligence or wilfulness is indicated by its act on April 27, 1931, in releasing $525,450 cash as "excess", with full knowledge of the fact that mortgage collateral in the Trust Fund was in default in payment of principal for more than 60 days, and despite advice of its own counsel that the transaction was not authorized by the Trust Agreement, involved a "risk" and might subject petitioner "to a lawsuit" (F. 110, 112, 120, 121, 130, 205; R. 104-105, 158-159, 163, 165, 205). The degree of petitioner's negligence or wilfulness is also indicated by the transactions covered by the Third objection in authenticating bonds and then almost immediately accepting the same bonds for cancellation in lieu of cash collections on Trust Fund mortgages; transactions which the District Court and the Court of Appeals characterized as a "device to permit the debtor to retain cash which it should have deposited in the trust fund" (R. 263-264; RB. 163; 207 F. 2d 81).

actions, however, all occurred after January 2, 1932, the date the Guarantor of the bonds announced and notified petitioner that it would not pay principal of maturing bonds; three of the transactions occurred after the Debtor defaulted in payment of the bonds (F. 13, 14, 16; R. 128). The bonds, moreover, which petitioner accepted and cancelled in lieu of the cash, all were authenticated during 1932, they all matured in less than six months after the dates of authentication, they all were cancelled shortly after authentication and before maturity, and none had ever been issued or sold to the public (F. 222-242; R. 186-190).

The Master sustained the Third objection to three of the transactions and surcharged petitioner $3,966.68 (R. 238). The District Court Judge sustained the objection in its entirety and surcharged petitioner the full amount of $16,716.66 (R. 16), holding that "the authentication and cancellation of these bonds under such circumstances was merely a device to permit the Debtor to retain cash which it should have deposited in the Trust Fund" (R. 263-264). The Court of Appeals, agreeing with the District Court Judge that the transactions were a "device" to circumvent the Trust Agreement, affirmed (RB. 163; 207 F. 2d 77).

Summary of Argument

The petition lacks substantial grounds. The case does not have "particular importance far beyond the particular facts and parties involved".[4]

The case involved an interpretation of a trust instrument and turned upon findings of disputed facts made by a Special Master, accepted by the District Court Judge and the Court of Appeals; findings which petitioner here accepts (Pet., p. 13).

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[4] Address of the late Chief Justice Vinson to American Bar Association, St. Louis Daily Record, Sept. 8, 1949, col. 7.

Petitioner's assertions that the Court of Appeals disregarded the Trust Agreement, disregarded applicable State law, and applied their "highly personal views of socially desirable conduct" (Pet., p. 18) are without substance.

There is no intra-circuit conflict between this case and *Prudence-Bonds Corp.* v. *State Street Trust Company* (C. A. 2), 202 F. 2d 555, cert. denied, ... U. S. ....., 74 S. Ct. 47. The asserted conflict arises from differences in states of fact and is no ground for review on writ of certiorari.

ARGUMENT

I

The Court of Appeals did not disregard the Trust Agreement.

Petitioner, in support of its contention that the Court of Appeals disregarded the Trust Agreement, relies upon the clause, quoted *supra*, p. 7, providing for what petitioner calls "Certificates of Non-Default" (Pet., p. 8). Petitioner's contention is that this clause exculpated it from liability. The contention was rejected by the Master, the District Court Judge and the Court of Appeals (R. 114-118, 254-255; RB. 162-163; 207 F. 2d 80-81).

Petitioner has not stated the facts found below which it here accepts. The Trust Agreement clause petitioner relies upon provided that in releasing cash or securities petitioner "may accept as conclusive the written statement of any officer of the (Debtor) Corporation as to whether or not any securities deposited in the Trust Fund are in default in the payment of principal or interest" (R. 284). Petitioner, while stating that in connection with all but one of the Second objection cash releases "the Debtor furnished and the Trustee acted upon a certificate of an officer of the Debtor" (Pet., p. 9), has carefully refrained from saying that it received and accepted "as conclusive" certificates of the kind provided for by the Trust Agreement.

The facts found below are that in respect of one of the twelve Second objection cash releases petitioner did not receive any statement from the Debtor regarding the condition of the Trust Fund; in respect of five of the releases it received statements to the effect that none of the Trust Fund securities was "in default in the payment of principal or interest for sixty days or more"; in respect of the remaining six releases it received statements to the effect that none of the Trust Fund securities was "in default in the payment of principal for sixty days or more" (RB. 162; F. 208, 213; R. 183, 184).

Thus, in one instance petitioner did not receive any statement regarding defaults, in five instances it received one kind of statement, in six instances another kind of statement, and in no instance a statement of the kind provided for by the Trust Agreement, which explicitly required a "whether or not" statement regarding all defaults, both principal and interest, whether one or more days old.

Petitioner, moreover, had possession of the Trust Fund securities and knowledge of the terms thereof; it received each month a statement from the Debtor which informed it what principal and interest had been collected and not collected on the Trust securities; it recorded the collections in its books of account pertaining to the Trust. Petitioner had actual knowledge from its own records whether or not the Trust Fund contained defaulted securities (F. 57, 69, 75-79; R. 140, 144-145, 147-148).

The Master found, and the District Court Judge and the Court of Appeals accepted his findings, that on the date of each release of cash, Trust Fund mortgages were in default in the payment of principal for more than 60 days; that on the dates of certain of the releases mortgages were in default in the payment of interest; that petitioner had knowledge of the defaults; that the statements petitioner received "did not comply with" the Trust Agreement; that petitioner did not "accept as conclusive" any of the statements it received; and that petitioner "did not receive, in connection with any of the releases of cash enumerated in

the Second objection herein, any written statement of an officer of the Debtor as to whether or not any securities deposited in the Trust Fund were in default in the payment of principal or interest" (F. 145-148, 168, 169, 205-211, 213-218; R. 169-170, 174, 182-186). The Court of Appeals said (RB. 162; 207 F. 2d 81):

> "* * * Both the Master and the district judge found that the Bank did not accept these statements as conclusive. It had full knowledge of the default in the Hillman mortgage which we have set forth above; and it had full knowledge of the default in interest on the Elmhurst-Hampton mortgage * * * and that the entire principal was and had been callable * * *. Such exculpatory provisions should be 'strictly construed' * * *; and such knowledge might in any event be sufficient, whatever the notices. But it is apparent that * * * the notices were quite inadequate; * * *."

There is not the slightest foundation for petitioner's assertions that the Court of Appeals "baldly disregarded" the Trust Agreement, "flatly ignored the intent of the parties", and took the position "that the agreement between the parties can and should be disregarded and be replaced by the particular judges' own fluid concepts of the scope of an indenture trustee's obligations" (Pet., pp. 13, 15, 18).

The statement of the case, set forth above, and the thorough, well reasoned opinion of the Court of Appeals (RB. 142-164; 207 F. 2d 67) show beyond doubt that the Court of Appeals, applying established principles of construction, interpreted the Trust Agreement reasonably in accordance with its dominant intent and purpose, and, agreeing with the Master's findings of fact, held that petitioner had been negligent, had violated "explicit" provisions of the Trust Agreement, and should be surcharged for the loss its devastavits caused the Trust Fund. The Court of Appeals, quoting from and following its decision in *President and Directors of Manhattan Co.* v. *Kelby*, *supra*, involving a similar trust agreement and similar unauthorized releases of trust fund cash, said (RB. 154; 207 F. 2d 76):

> " * * * 'the release clause, as we have construed it, expresses the agreement's dominant purpose in the light of which its other provisions to which the Bank refers must be interpreted,' that dominant purpose being 'that the trust fund was equally to secure all the bonds.' This construction makes the entire agreement consistent and avoids 'an intention which verges on dishonesty.' It accords to the 60-day default provision the intent to assure speedy elimination of stale defaulted securities, rather than to increase the assets subject to withdrawal. And it avoids the anomaly of the district court's view, which requires the writing into this negative restriction of an affirmative grant neither stated nor implied. * * *
>
> * * * this seems to us a reasonable construction of the trust along lines already established by this court * * *."

Surely, this decision, involving an interpretation of a trust instrument and turning upon facts disputed by and found against petitioner by the Master, the District Court Judge and the Court of Appeals, does not present any substantial question meriting review by this Court.

II

The Court of Appeals did not disregard applicable State law.

Petitioner, arguing that the Court of Appeals disregarded applicable State law, cites only *Hazzard* v. *Chase National Bank,* 159 Misc. 57, aff'd 257 App. Div. 950, 282 N. Y. 652, cert. denied, 311 U. S. 708 (Pet., pp. 23-24).

The instant decision is plainly not in conflict with the *Hazzard* decision which involved a different set of facts and a different trust instrument. The trustee in the *Hazzard* case was saved from liability by an exculpatory clause of a type characterized as "particularly vicious" (159 Misc. 76), which limited liability to gross negligence and

bad faith; a provision not contained in the instant Trust Agreement (R. 273-317). As Judge Learned Hand said in *Manufacturers Trust Co.* v. *Kelby, supra* (125 F. 2d 650, 654):[5]

> "* * * The comments relied upon in *Hazzard* v. *Chase National Bank,* 159 Misc. 57, 287 N. Y. S. 541, affirmed 257 App. Div. 950, 14 N. Y. S. 2d 147, do not mean that such trustees should not be held to such of their liabilities as such as they do not succeed in evading by stipulations in the trust instruments; on the contrary they were made in reprobation of the extent to which they do succeed in escaping those obligations, while continuing to hold themselves out as trustees."

The Court of Appeals in the instant case, as its opinion shows, applied and followed its decision in *President and Directors of Manhattan Co.* v. *Kelby, supra,* where it applied and followed New York law (RB. 142-164; 207 F. 2d 67). The Court of Appeals said (RB. 151; 207 F. 2d 74):

> "* * * The situation seems to us to be controlled by both the ruling and rationale of *President and Directors of Manhattan Co.* v. *Kelby, supra,* 2 Cir. 147 F. 2d 465, involving the Fifth and Ninth Series of Prudence-Bonds."

Petitioner's contention that the Court of Appeals disregarded applicable State law is unsubstantial. Petitioner made no such contention in its petition to the Court of Appeals for rehearing (RB. 166-172).[6]

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[5] See also further comment of Judge Learned Hand about the *Hazzard* case in *Dabney* v. *Chase Bank,* 196 F. 2d 668, 671.

[6] In its petition for rehearing, petitioner contended only that the Court of Appeals had erroneously determined issues of fact whether Trust Fund mortgages were in default in payment of principal on the dates of certain of the Second objection releases of cash (RB. 166-172). In our answer to the petition we demonstrated that there was no merit to the contention (RB. 174-196). Petitioner here accepts the facts found against it below (Pet., p. 13).

III

There is no intra-circuit conflict between this case and *Prudence-Bonds Corp.* v. *State Street Trust Company* (C. A. 2), 202 F. 2d 555, cert. denied, ... U. S. ....., 74 S. Ct. 47.

Petitioner's statement that this case deals with the "identical issue" involved in the *State Street Trust Company* case and was determined "in precisely the opposite manner" with a "squarely conflicting result" (Pet., p. 15) is erroneous. The statement has no more substance than petitioner's charge that the Judges of the Court of Appeals disregarded the Trust Agreement and the law and applied their "highly personal views of socially desirable conduct" (Pet., p. 18).

The two decisions are not in conflict. The asserted conflict arises from differences in states of fact and presents no ground for the issuance of certiorari.[7]

The two cases are clearly distinguishable upon the facts.

The *State Street Trust Company* case involved a trustee's inaction or nonfeasance in failing to take timely steps to enforce a guaranty constituting part of the trust *res*. The Court of Appeals, Judge Frank dissenting, held that the trustee was immunized against liability by an exculpatory clause which the majority Judges construed "to give complete immunity to the Trustee for any nonfeasance in suing either the mortgagors or the Guarantor" (202 F. 2d 555, 564).

No such exculpatory clause is involved or was construed in the instant case. Petitioner has not been surcharged for inaction; it has been surcharged for misfeasance, for its negligent, unauthorized, affirmative acts in wrongfully releasing Trust Fund cash.

Manifestly, a provision immunizing a trustee from liability for failure to sue a mortgagor or guarantor does not

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[7] *Wisconsin Electric Co.* v. *Dumore Co.*, 282 U. S. 813.

relieve the trustee from liability for wrongfully releasing or disbursing trust fund cash.

Indeed, Judge Learned Hand in his majority opinion in the *State Street Trust Company* case specifically distinguished the two situations. He referred to his own decision in *Manufacturers Trust Co.* v. *Kelby,* supra (125 F. 2d 650, 653-654), and pointed out that a doctrine of New York law applying to a trustee's inaction in failing to take timely steps "to protect the *res* * * * did not apply to a breach that was a 'surrender or release' of any part of the *res*" by positive action (202 F. 2d 559). Judge Learned Hand there further said that bondholders "expect" that their indenture trustees will take "no action which will positively impair their interests" (202 F. 2d 564).

The absence of a conflict is further evidenced by the fact that the Court of Appeals in the instant case twice cited with approval the *State Street Trust Company* case (RB. 158, 162; 207 F. 2d 78, 81).

A further fact of special significance, particularly when considered in the light of petitioner's assertion that there is a "sharp" and "striking" conflict between the instant case and the *State Street Trust Company* case (Pet., pp. 3, 16), is that petitioner's counsel, in their petition to the Court of Appeals for rehearing, did not suggest, let alone assert, that the two decisions are in conflict; they indeed did not even mention the *State Street Trust Company* case (RB. 166-172).

In still another way it may be shown that there is no intra-circuit conflict.

The *State Street Trust Company* case was decided by Judges Learned Hand and Swan, with Judge Frank dissenting. The instant case was decided unanimously by Judges Chase, Clark and Frank who cited and followed the unanimous decision of Judges Swan, Clark and Frank in *President and Directors of Manhattan Co.* v. *Kelby, supra.* Thus, the instant unanimious decision of Judges Chase, Clark and Frank accords with the views of Judge Swan who concurred with Judges Clark and Frank in the *Presi-*

dent and Directors of Manhattan Co. case and with Judge Learned Hand in the *State Street Trust Company* case.

Furthermore, there have been three other unanimous decisions of the Second Circuit Court of Appeals in these same Prudence-Bonds Corporation accountings. *Central Hanover B. & T. Co.* v. *President and Directors of the Manhattan Co., supra,* was decided by Judges Learned Hand, Augustus N. Hand and Patterson; *Manufacturers Trust Co.* v. *Kelby, supra,* by Judges Learned Hand, Chase and Clark; *Brooklyn Trust Co.* v. *Kelby, supra,* by Judges Swan, Augustus N. Hand and Frank. Judge Frank participated in four of the six cases, Judges Learned Hand, Swan and Clark each participated in three of the cases, Judges Augustus N. Hand and Chase each participated in two of the cases, and the late Judge Patterson in one of them.

The Judges of the Second Circuit Court of Appeals are, therefore, especially familiar with the Trust Agreements and the issues involved in these accountings. This Court has four times declined to review their decisions in the cases.

All these facts and factors, coupled with the fact that the *State Street Trust Company* case, as Judge Learned Hand himself there pointed out, dealt with a factual situation materially different from that involved in the instant case and in the *President and Directors of Manhattan Co.* case, demonstrate conclusively that there is no basis for petitioner's statement that "there is a striking and continuing divergence in the views of various panels of the Second Circuit on the basic rules applying to trust agreements" (Pet., p. 16).

It plainly appears that there is no intra-circuit conflict. There is, therefore, no need to consider petitioner's further contention that the Court of Appeals should have heard the case *en banc* to "remove" the conflict (Pet., pp. 21-23). Petitioner, moreover, did not on the appeal or in its petition for rehearing suggest or request that the Court of Appeals sit *en banc* (RB. 166-172).

CONCLUSION

The petition for a writ of certiorari lacks substantial grounds and should be denied.

Respectfully submitted,

CHARLES M. MCCARTY,
Counsel for Respondent
Prudence-Bonds Corporation
(New Corporation).

GEO. C. WILDERMUTH,
Counsel for Respondent
Louis J. Castellano, Jr.,
Successor Trustee of Debtor.

SAMUEL SILBIGER,
Counsel for Respondent
George E. Eddy.

AARON SCHWARTZ,
Counsel for Respondents
Rosalie Samson,
Gottlieb Trading Company,
Transient Trading Company,
Keystone Investing Company,
Mardel Company,
Rego Trading Company and
Estate of Herman Gottlieb.

January 21, 1954.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

No. 516

CHEMICAL BANK & TRUST COMPANY,
Petitioner,

v.

PRUDENCE-BONDS CORPORATION (New Corporation), *et al.,*
Respondents.

REPLY MEMORANDUM FOR PETITIONER CHEMICAL BANK & TRUST COMPANY

JOHN LORD O'BRIAN
PHILIP A. CARROLL
JOHN A. WILSON
Counsel for Petitioner

LESTER KISSEL
and
SHEARMAN & STERLING & WRIGHT
20 Exchange Place
New York 5, N. Y.
Of Counsel

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REPLY MEMORANDUM FOR PETITIONER CHEMICAL BANK & TRUST COMPANY

Since the carefully selected facts set forth in respondents' brief in opposition may obscure the basic question presented, petitioner Chemical Bank & Trust Company is compelled to file this reply memorandum. The issue for this Court's decision is squarely and properly presented in the petition for certiorari. Cardinally, the question is whether the reasonable terms of the trust agreement, adopted in good faith and acted upon by the parties, may be disregarded, as they were by the Court of Appeals.

The question is graphically framed by the handling below of the Second Objection. This objection, which involves the bulk of the surcharge and has been the focal point of the proceedings, challenged the propriety

of several releases of excess cash collateral to the debtor Prudence-Bonds Corporation. As was shown in the hearings before the special master, the trust agreement, as made and consistently followed by the parties, called for the exclusion only of mortgages in default *in the payment of principal for more than sixty (60) days* in determining whether there was excess collateral in the trust fund subject to withdrawal. See petition for certiorari, pp. 7-8.

In the whole of their brief, respondents do not even mention this settled construction of the trust agreement, nor the "clear day" when the trust fund was in balance which resulted from its application. This area is completely passed over by respondents, despite the plain fact that it forms the framework of the litigation and accounts for over $900,000 of the total surcharge imposed of $1,061,966.66 (and for a corresponding portion of the more than $700,000 in interest). Although respondents in the brief in opposition discuss facts and findings for several pages, they do not—and cannot on the record—suggest that the special master or either court below found that this was not the settled construction of the trust agreement.

Indeed, the case was tried and briefed before the special master—by all parties to the proceeding—upon the uncontested premise that, in determining whether there was excess collateral in the trust fund, mortgages in default for less than the 60-day period or in default solely as to interest were included in the trust fund.[1]

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[1] Respondents also accepted this construction in proceedings in connection with the Fourteenth Series of Prudence-Bonds.

The Second Objection, as stated by respondents Prudence-Bonds Corporation and the Reorganization Trustee in their formal objections to petitioner's account, was based on this settled construction of the trust agreement.

Thus respondents objected to the releases on the alleged ground that at the time of each release a mortgage in the trust fund was "in default in payment of principal for more than sixty (60) days . . ." (R. 61). Similarly, respondents did not object to three withdrawals aggregating $59,900 which, thereafter, left the fund equal to the bonds outstanding only if the fund included mortgages in principal default for less than sixty days. Clearly, respondents too recognized the settled construction of the trust agreement.

The District Court, in holding that there was a "clear day" on June 4, 1931, concluded that the construction acted upon by the trustee and the debtor was the one plainly called for under the terms of the trust agreement which, as the District Court opinion points out, provided that if any of the securities deposited in the trust fund *"shall be in default in the payment of principal for more than 60 days the Corporation shall be permitted to withdraw only such securities . . . as shall be so in default . . ."* (R. 256-258; emphasis in original).

Finally, and most important, the Court of Appeals did not resolve this paramount issue against petitioner by reliance on facts or findings contrary to petitioner's position. On the contrary, the Court of Appeals consciously and explicitly ignored the intent of the parties and the meaning of the trust agreement. There

can be no argument on this score. As the Court of Appeals stated:

> "It may be noted that the Bank urges vigorously a settled construction of the trust agreement made and acted upon by the parties at the time, contrary to our conclusion and in accord with the view of the district judge. But the parties were the Trustee and the debtor corporation; overlooked entirely are the bondholders for whom the protective provisions were drawn." (207 F. 2d 67, 77) [2]

In short, as the petition states and as the decision below itself plainly demonstrates, the panel of the Court of Appeals which sat in this case disregarded the reasonable terms of the agreement and surcharged the trustee, in the words of Judge Frank in his dissent in the conflicting *State Street Trust Company* case, on "the court's notion of . . . socially desirable conduct" and "entirely without regard to the parties' intention."

The welter of facts catalogued by respondents cannot serve to change the posture of this litigation. It is not the function of this memorandum to retrace the continuing conflict among the panels of the Court of Appeals for the Second Circuit or the other points covered in the petition for certiorari. It is designed only to point out that the question—of consuming importance

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[2] As set forth in the petition for certiorari (pp. 15-16), Judge Learned Hand, in the *State Street Trust Company* case, concluded that protection of the bondholders' interest, used as the basis for disregarding the terms of the trust agreement here, did not require or justify the court's refusing to give effect to the agreement between the debtor and trustee.

to the financial community and bondholders everywhere —is cleanly presented on this record and is in need of determination by this Court.

Respectfully submitted,

JOHN LORD O'BRIAN
PHILIP A. CARROLL
JOHN A. WILSON
Counsel for Petitioner

LESTER KISSEL
and
SHEARMAN & STERLING & WRIGHT
20 Exchange Place
New York 5, N. Y.
Of Counsel

January 22, 1954.